Re AT&T Communications of New England, Inc.
D.P.U. 91-79

Massachusetts Department of Public Utilities
June 22, 1992

APPEARANCES: Harry M. Davidow, Esq., 32 Avenue of the Americas, New York, New York 10013, and Jeffrey F. Jones, Esq., Palmer & Dodge, One Beacon Street, Boston, Massachusetts 02108, FOR: AT&T COMMUNICATIONS OF, NEW ENGLAND, INC., Petitioner. L. Scott Harshbarger, Attorney General, By: Edward G. Bohlen, Esq., Assistant Attorney General, Regulated Industries Division, Public Protection Bureau, 131 Tremont Street, 3rd Floor, Boston, Massachusetts 02111, Intervenor. Carl D. Giesy, Esq., Five International Drive, Rye Brook, New York 10573, FOR: MCI TELECOMMUNICATIONS CORPORATION, Intervenor. Keith Townsend, Esq., 1850 M Street, N.W., Suite 1110, Washington, D.C. 20036, FOR: SPRINT COMMUNICATIONS COMPANY L.P., Intervenor. A. Eric Rosen, Esq., Bruce P. Beausejour, Esq., 185 Franklin Street, Room 1403, Boston, Massachusetts 02107, FOR: NEW ENGLAND TELEPHONE AND, TELEGRAPH COMPANY, Intervenor. Stephen Ostrach, Esq., 150 Lincoln Street, Boston, Massachusetts 02111, FOR: NEW ENGLAND LEGAL FOUNDATION, Limited Participant.

Before Yardley, Jr., chairman.

BY THE COMMISSION:

I. INTRODUCTION

A. Procedural History

***1** On April 12, 1991, AT&T Communications of New England, Inc. ("AT&T" or "Company") filed with the Department of Public Utilities ("Department"), pursuant to G.L. c. 159, § 12 and 220 C.M.R. 1.04, a petition for an alternative mode of regulation of the Company's Massachusetts intrastate telecommunications services. [FN1] AT&T proposed that the Department establish two broad service classifications for the purpose of regulating AT&T's Massachusetts intrastate services. The two service classifications would consist of "Category M" services (market-based pricing would be permitted) and "Category D" services (Department regulation of prices would continue). AT&T also proposed that traditional rate-of-return ("ROR") regulation be eliminated for the Company's intrastate operations and that the Department establish new reporting requirements for interexchange common carriers ("IXCs"). [FN2]

Also on April 12, 1991, AT&T filed a motion to defer the filing requirements directed by the Department in D.P.U. 90-133, pending the outcome of the Company's request for an alternative mode of regulation in this case. [FN3] On May 1, 1991, the Department granted that motion.

On July 12, 1991, AT&T filed the direct testimony of (i) Marc Rosen, government affairs vice president of AT&T, (ii) Lee J. Globerson, district manager of state government affairs for AT&T, and (iii) Jerry Hausman, a professor of economics on the faculty of the Massachusetts Institute of Technology. Subsequently, on December

18, 1991, AT&T withdrew the testimony of Dr. Hausman and substituted the direct testimony of John W. Mayo, an associate professor of economics on the faculty of the University of Tennessee.

The Attorney General of the Commonwealth ("Attorney General") intervened pursuant to G.L. c. 12, § 11E. The following parties also were granted intervenor-status: MCI Telecommunications Corporation ("MCI"), Sprint Communications Company L.P. ("Sprint"), [FN4] and New England Telephone and Telegraph Company ("NET"). The New England Legal Foundation ("NELF") was granted status as a limited participant.

On February 26, 1992, Sprint filed the direct testimony of Kenneth M. Prohoniak, staff director of regulatory affairs for Sprint's Atlantic and Northeast divisions. On February 27, 1992, the Attorney General filed the direct testimony of William G. Shepherd, a professor of economics on the faculty of the University of Massachusetts.

On April 2, 1992, AT&T filed the rebuttal testimony of Dr. Mayo.

Five days of evidentiary hearings were conducted, beginning on February 3, 1992 and ending on April 3, 1992. The evidentiary record includes 106 exhibits and twelve responses to record requests. The Company submitted 27 exhibits, the Attorney General submitted sixteen exhibits, Sprint submitted six exhibits, MCI submitted one exhibit, and the Department submitted 56 exhibits. Also included in the evidentiary record are fourteen exhibits from docket D.P.U. 90-133 that were incorporated into the record in this case pursuant to 220 C.M.R. 1.10(3). Official notice was taken by the hearing officer, pursuant to 220 C.M.R. 1.10(2), of the following order issued by the Federal Communications Commission ("FCC"): Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880 (1991).

***2** On April 23, 1992, initial briefs were filed by AT&T, the Attorney General, Sprint, and MCI; on that same date, NET filed a letter commenting on issues raised by the proceeding. On May 7, 1992, reply briefs were filed by AT&T, the Attorney General, Sprint, MCI, and NELF.

B. Background

In 1985, the Department established a framework of regulation for common carriers certified to provide telecommunications services within Massachusetts. IntraLATA Competition, D.P.U. 1731 (1985) ("IntraLATA Competition"). Under the framework set forth in that Order, the degree of regulation depends on whether a carrier is "dominant" or "nondominant" in its respective market(s). In that Order, the Department determined that AT&T is a dominant carrier in the interLATA market, and that both AT&T and NET are dominant carriers in the intraLATA market. The Department determined that all other carriers are nondominant in their provision of telecommunications services. Id., p. 69.

In June 1990, pursuant to 220 C.M.R. 1.04 and the provisions of IntraLATA Competition, AT&T filed a petition with the Department to be reclassified as a "nondominant" telecommunications carrier in Massachusetts. See AT&T Communications of New England, Inc., D.P.U. 90-133 (1991) ("D.P.U. 90-133"). The Department issued an Order in that case in January 1991, in which the relief requested by AT&T was denied. In that Order, however, the Department declined to make any findings regarding the appropriateness of alternatives to ROR regulation for the Company's intrastate services, because there was no notice on that issue and because the

record contained little evidence on which to make such findings. D.P.U. 90-133, p. 33, n.8. In addition, the Department indicated that AT&T could petition the Department to have a particular service or services declared sufficiently competitive. [FN5] Id., pp. 32-33.

In this proceeding, AT&T has petitioned the Department for an alternative form of regulation, under which certain services would be declared sufficiently competitive; however, AT&T is not requesting a change in its classification as a dominant carrier.

C. Procedural Matter

On May 12, 1992, the Attorney General filed a Motion to Strike Portions of AT&T's Briefs ("Motion to Strike"). The Attorney General requests that page 59 in AT&T's initial brief and pages 22 through 24, 26, 30 through 33, and 42 through 45 in AT&T's reply brief be stricken and removed from consideration by the Department in this case (Motion to Strike, p. 1). The Attorney General contends that the arguments, quotations, and discussions contained in those pages are based on portions of two texts that are not included in the record in this case (id.).

One text is The Economics of Industrial Organization (3d ed. 1990) ("Shepherd Text"). The author, William G. Shepherd, is the Attorney General's witness in this case. A copy of portions of the text (cover page, contents reference, and pages 409 through 414) was offered by the Attorney General as evidence and admitted into the record as Exhibit AG-9 (Tr. 4, pp. 264-265). The remainder of the text neither was offered nor admitted into the record as evidence, including the portions cited and discussed on the contested pages of AT&T's briefs.

***3** The other text is F.M. Scherer and David Ross, Industrial Market Structure and Economic Performance (3d ed. 1990) ("Scherer and Ross Text"). No portion of this text was offered or admitted into the record as evidence. The Attorney General contends that the only record evidence concerning the contents of this text was supplied by Dr. Shepherd, where he rejected the interpretation of the text by AT&T's counsel (Motion to Strike, p. 3).

The Attorney General argues that the Department should strike the specified pages from AT&T's briefs because the arguments, quotations, and discussions contained in those pages are based on material not in the record.

On May 19, 1992, AT&T filed an Opposition to the Attorney General's Motion to Strike ("AT&T Opposition"). The Company asserts that it cited the two texts in its briefs for the purpose of discussing general economic principles, and not for the purpose of relying on any facts specific to AT&T (AT&T Opposition, pp. 3-4, 7). AT&T contends that courts and regulatory agencies commonly cite "scholarly authorities" for basic economic concepts and methods of analysis without requiring that the writings be placed into evidence or that their authors be made available as witnesses (id., pp. 3-4).

AT&T points out that there was no objection to the Company's use of those two texts during its cross-examination of Dr. Shepherd (id., p. 5). The Company maintains that, just as it was appropriate to use those texts in the course of cross-examination, it similarly was appropriate to use those texts on brief to "demonstrate the weaknesses, inconsistences, flaws, and other shortcomings" of Dr. Shepherd's testimony (id., pp. 5-6). AT&T asserts that by use of these two texts, and others, the Company has demonstrated that the economic principles explained in

the major economic texts are inconsistent with the positions taken by Dr. Shepherd (id., p. 7). Thus, the Company requests that the Motion to Strike be denied (id., p. 8).

On May 26, 1992, the Attorney General submitted a reply to AT&T's Opposition ("Attorney General Reply"). In response to the Company's arguments, the Attorney General contends that AT&T's use of the two texts in question did raise significant disputed issues of fact (Attorney General Reply, p. 1). The Attorney General maintains that AT&T's interpretation of these two texts on brief is contrary to the evidence presented by the Attorney General (id.). The Attorney General further asserts that this dispute illustrates that it is nearly impossible to distinguish factual discussions from "scholarly" discussions (id.).

A brief is the vehicle for a party to present its argument to the reviewing authority based on the facts in the record, the law that the party would have applied, and the resulting application of the law to the facts sought by that party. Douglas v. Martin, 228 P.2d 1021, 1022-1023 (Okla. Sup. Ct. 1951). Any statement of fact in a brief requires an appropriate and accurate record reference. See, e.g., M. R. App. Proc. Rule 16(e). A brief cannot serve the purpose of presenting facts that do not appear in the record. Loyal Protective Life Ins. Co. v. Massachusetts Indemnity and Life Insurance Co., 362 Mass. 484, 495 (1972); Cral v. Leominster, 362 Mass. 95, 105 (1972).

***4** The Department can strike extra-record evidence from a brief and require the offending party to file a conforming brief without reference to the excluded evidence. [FN6] Boston Edison Co. v. Brookline Realty & Inv. Corp., 10 Mass App. Ct. 63, 69 (1980). A lesser remedy is to strike the offending portions from the brief and to disregard those portions of the brief in reaching a decision in the case. Service Publications, Inc. v. Goverman, 396 Mass. 567, 580 (1986); Roberto Construction Co., Inc. v. Burnham-Manning Post No. 1105, 347 Mass. 400, 403 (1964); Hull Municipal Light Plant, D.P.U. 87-19-A, p. 7 (1990); Boston Edison Company, D.P.U. 90-335, pp. 7-9 (1992).

The Department is aware that courts and regulatory agencies cite in their decisions to so-called "scholarly writings" without requiring that the cited authorities be placed in evidence or that the authors be available for cross-examination. [FN7] The Department should be expected to inform itself on general matters of law and in such areas as economics. The Department may exercise its independent judgment in relying on "scholarly writings" in support of a policy determination. However, for the most part, parties are expected to rely on record evidence when presenting arguments on brief. The parties may not rely on extra-record material to present facts in dispute.

In this case, the Company has made use of the Shepherd Text to impeach the credibility of Dr. Shepherd and to rebut his testimony. The Shepherd Text may well be a "scholarly writing" that could be cited without the need to place it in evidence. However, in this case it is important that Dr. Shepherd appeared as a witness and was available for cross-examination (Tr. 4, pp. 4-262). While impeachment and rebuttal argument may be presented on brief, they are best conducted in the course of hearings as part of witness examination and cross-examination.

The Company clearly was aware of the Shepherd Text (see, e.g., id., pp. 161-162). The Company had sufficient opportunity to cross-examine Dr. Shepherd on his writings. The Company also had the opportunity to present a rebuttal case. With these opportunities to address any perceived inconsistencies in Dr. Shepherd's testimony, it is inappropriate for AT&T to attempt such impeachment and rebuttal on

brief. If Dr. Shepherd had been questioned in hearings on the issues now raised in AT&T's briefs, he may have offered further explanation, refined his earlier testimony, or even changed his earlier testimony. With Dr. Shepherd available, the hearing process, and not the briefing stage, was the best place to resolve the issues.

Therefore, we find that AT&T's citations in its briefs to the Shepherd Text and its associated argument based on the Shepherd Text were inappropriate. Accordingly, we remove from consideration in this case and strike the following portions of AT&T's briefs as they relate to the Shepherd Text: page 59 of AT&T's initial brief, and pages 22, 23, 24, 26, and 44 of AT&T's reply brief.

***5** Regarding the Scherer and Ross Text, we find that AT&T primarily referred to this text in its reply brief to refute the testimony of Dr. Shepherd pertaining to the concept of market power. [FN8] The appropriate means of determining market power for AT&T became an issue in this case, with the Company and the Attorney General presenting differing theories in each of their direct cases. Instead of presenting references to the Scherer and Ross Text on brief, the Company should have made use of cross-examination of Dr. Shepherd and its own rebuttal testimony to rebut Dr. Shepherd's theories on market power. [FN9] Therefore, we find that it was not proper for AT&T to cite to the Scherer and Ross Text on brief to present facts on the issue of the disputed fact of the analysis of market power. Accordingly, we remove from consideration in this case and strike the following portions of AT&T's reply brief as they relate to the Scherer and Ross Text: pages 30 through 33, 42, 43, and 45.

In so ruling, we recognize that, in the proper circumstances, parties may rely on extra-record "scholarly writings" for the purpose of identifying general principles, descriptions, or definitions. Nevertheless, such extra-record "scholarly writings" may not be used to present facts in dispute. The weight to be accorded a reference to a "scholarly writing" will depend on the level of acceptance of the writing as authoritative in the relevant field of expertise. Also, it will be important that the material be available to the parties to the case, and that the parties have fair notice of its use.

II. COMPANY'S PROPOSAL

In April 1991, AT&T filed a petition with the Department in which it requested an alternative form of regulation. AT&T submitted the details of this plan in July 1991. In particular, the Company requested that a number of its services be declared "sufficiently competitive" (and classified as "Category M" services) [FN10] and that the Department adopt an alternative to ROR regulation for AT&T's Basic message telecommunications service ("MTS", commonly known as intrastate long-distance service) [FN11] and operator services [FN12] in Massachusetts (both to be classified as "Category D" services). AT&T argues that the first task of this proceeding "is to determine for which of AT&T's services competition is sufficient to warrant reliance on market forces to control price" (AT&T Initial Brief, p. 3).

Specifically, the Company has proposed a weighted-average price cap for Basic MTS (See § VI, infra); continuation of statewide average pricing; continuation of unrestricted resale of its services; adoption of a new procedure by which the Department would monitor the markets for telecommunications services in Massachusetts; and continuation of existing procedures by which the Department addresses consumer complaints (AT&T Brief, pp. 5-6).

III. REGULATORY STANDARDS FOR INTEREXCHANGE COMMON CARRIERS

The basic structure for the Department's regulation of intrastate telecommunications service within the Commonwealth is provided by G.L. c. 159. Within this structure, the Department has broad general power over the provision of telecommunications services. G.L. c. 159, § 12. It is under this authority that the Department established the dominant/nondominant structure for the regulation of IXCs in the provision of intrastate services, within which AT&T is regulated as a dominant carrier. See generally, IntraLATA Competition.

***6** An important element of the regulation of all intrastate telecommunications services is the requirement that carriers file with the Department, in the form of tariffs, all rates, charges, terms, and conditions relating to the provision of service within Massachusetts. G.L. c. 159, § 19; see also, 220 C.M.R. 5.00. Furthermore, changes in existing tariffs or the introduction of new services by tariff may take effect only upon not less than 30 days' notice, unless the Department finds good cause for a shorter notice period. G.L. c. 159, § 19; see also, 220 C.M.R. 1.04(1)(b).

Intrastate telecommunications carriers may charge only those rates that are just and reasonable. G.L. c. 159, § 17. Upon a carrier's filing a change in its tariff or filing a new tariff, the Department has the authority to suspend the operation of the proposed tariff for up to six months to allow for an investigation into the justness and reasonableness of the rates and terms. G.L. c. 159, § 20; G.L. c. 25, § 18. Also, on its own motion, the Department may investigate the rates, regulations, or practices of telecommunications carriers to determine whether they are unjust, unreasonable, or unduly discriminatory. G.L. c. 159, § 14. Each carrier must also file an annual return with the Department providing basic information on its intrastate operations. [FN13] G.L. c. 159, § 32; G.L. c. 166, § 11.

In addition to the regulatory structure established by these express statutory provisions, the Department exercises general supervisory authority under G.L. c. 159, § 12 to establish appropriate public policy for the provision of telecommunications service in Massachusetts. In the mid-1980s, in recognition of evolving competition from new participants in telecommunications markets, the Department developed a new regulatory framework, based on broad public policy goals. The purpose of establishing these goals was "to define a clear direction for the telecommunications industry in the state and . . . [to] provide for the continued development of the most efficient and modern telecommunications network possible." IntraLATA Competition, pp. 18-19.

The three public policy goals adopted by the Department in IntraLATA Competition were economic efficiency, fairness, and universal service. Id., pp. 19-24. As defined by the Department in that Order, economic efficiency means that rates are cost-based and reflect the cost to society of the resources consumed to produce the carrier's service; fairness means that no class of customers should pay more than the cost to serve that class; and universal service means that the rate structure for telecommunications companies ensures rates that allow basic telecommunications services to be obtained by the vast majority of the state's population. [FN14] Id., pp. 20, 22-24.

These public policy goals were established in the course of the Department's examination of the development of competition and its effect in certain segments of telecommunications markets. The Department recognized the benefits inherent in a

competitive marketplace that could encourage greater levels of economic efficiency and fairness than does a regulated monopoly environment. Id., p. 26. We noted that a competitive market would better promote economic efficiency by requiring, in the long term, that prices be based on marginal costs. Id., p. 25. Furthermore, we noted that incentives will be created to minimize those costs in order to maintain and expand market share. Id. Also, we found that fairness may be furthered through competition because a competitive marketplace drives prices for services toward their economic costs, thus helping to ensure that any service class is not paying more than the cost of providing service to that class. Id. In addition, competition provides a market environment where the introduction and dissemination of technological innovation will be encouraged, and it promotes greater sensitivity to specific customer demands. Id. However, the Department recognized that a carrier's ability to manipulate the market through the use of predatory pricing practices would undermine the goals of economic efficiency, fairness, and universal service. Id., p. 28.

***7** As a means of addressing the complexities of evolving markets, the Department established the present dominant/nondominant structure, for the regulation of the provision of telecommunications services in Massachusetts. Id., pp. 57-65. The Department has determined that, within this regulatory structure, AT&T, as a dominant IXC, is required to provide full cost information for all services at the time of a requested rate increase. Id., p. 62. Full cost information means a fully allocated embedded cost of service study, incremental cost studies for all services, and rate-of-return documentation. Id.; see also, AT&T Communications of New England, Inc., D.P.U. 85-137 (1985). The Department also recognized that changed market conditions may warrant a different degree of regulation. IntraLATA Competition, p. 65.

The Department has continued to monitor the changes in telecommunications markets and has allowed flexibility in instances where it found that competition would adequately protect consumers' interests. One example is the Department's investigation of AT&T's proposed tariff provision for special pricing arrangements. AT&T - Special Pricing Arrangements, D.P.U. 90-24 (1991). In that proceeding, the Department considered whether competitive bids could form the basis for a lawful rate, and if so, what criteria should apply to the Department's evaluation of any customer-specific pricing tariffs that may be filed by dominant or nondominant carriers as a result of competitive bids. The Department also considered the appropriate treatment of any revenue shortfalls that might occur as a result of a customer-specific pricing of services at rates below those set forth in a Company's standard tariff. Id., p. 16.

In its decision in D.P.U. 90-24, the Department found that customer-specific pricing tariffs could be lawful under clearly competitive circumstances. The Department required that any customer-specific tariffs filed by AT&T be supported, inter alia, by marginal cost data. Id., pp. 20-21. Furthermore, the Department found that, consistent with the past treatment of competitive services, any revenue shortfall from competitive services may not be allocated to the carrier's noncompetitive services. Id., p. 22. Finally, the Department established requirements for supporting documentation by either nondominant or dominant carriers that file customer-specific pricing tariffs with the Department. Id.

We now consider AT&T's proposal for an alternative mode of regulation to determine whether that proposal satisfies the statutory requirements for the regulation of telecommunications service in Massachusetts and is consistent with the Department's telecommunications policy goals.

IV. STATEMENT OF ISSUES

AT&T's proposal for an alternative mode of regulation raises several important issues, including the determination of the proper framework for measuring the level of competitiveness of a market. In Section V, we consider this question in the context of AT&T's proposal for reclassifying many of its services as "sufficiently competitive." In general, a finding that a service is "sufficiently competitive" permits the Department to approve market-based pricing of the service. We also consider whether there are sufficient safeguards to protect against unfair pricing practices that potentially could result from market-based pricing.

***8** In Section VI, we examine AT&T's proposal to remove ROR regulation from those services that are not sufficiently competitive and consider AT&T's proposal to implement a weighted-average price cap for Basic MTS. We evaluate AT&T's price cap proposal in order to determine whether that pricing mechanism would result in just and reasonable rates.

In Section VII, we discuss the distinction between the "sufficiently competitive" classification and the "Category M" classification. In Section VIII, we consider the use of reporting requirements as a tool to evaluate the results of implementing an alternative regulatory framework.

In Section IX, we analyze the implications of this Order for providers of intrastate operator services. Section X summarizes the Department's findings in this Order.

V. AT&T's PROPOSED CATEGORY M SERVICES

A. Introduction

AT&T identifies certain services as Category M and proposes that the Department determine these services to be "sufficiently competitive." Under AT&T's proposal, neither the rates for Category M services nor for Category D services (See Sections VI and VII, infra) would be determinedthrough ROR regulation. Category M includes all of AT&T's services except operator services and Basic MTS. In IntraLATA Competition, the Department made provisions for certain services to be offered with prices set by competitive markets. In that Order, the Department said:

> [I]f an entire service class is determined to be fully competitive by the Department, we may find that prices set by the market are fair and reasonable, and we will regulate such service class in accordance with minimum statutory requirements. Such a determination may be made only upon a showing by NET that such a service class is fully competitive.

IntraLATA Competition, pp. 39-40.

For example, the Department has declared NET's Centrex and Intellidial services to be sufficiently competitive. See NET, D.P.U. 85-275/276/277 (1985) (Centrex); and NET, D.P.U. 88-18-A (1988) (Intellidial). In D.P.U. 90- 133, the Department discussed the potential application to AT&T's services of this regulatory option, stating:

AT&T, in its present status as a dominant carrier, may . . . request that certain services be classified as sufficiently competitive. If the Department grants such a request, appropriate costs would be allocated, in the event of a general rate case, to any services found to be sufficiently competitive. AT&T would not be permitted to shift unrecovered costs to other service categories. Similarly, any revenues associated with the sufficiently competitive services in excess of the costs assigned to the sufficiently competitive class would not be shifted to other service categories. Therefore, for those services for which the Department has ruled that AT&T faces sufficient competition, AT&T under the present regulatory framework and as a dominant carrier, may file tariffs that receive the same degree of scrutiny as those filed by nondominant carriers.

***9** D.P.U. 90-133, pp. 32-33 (citations omitted).

B. Positions of the Parties

1. AT&T

AT&T asserts that it has presented the proper framework for considering the competitiveness of the Category M services (AT&T Brief, p. 16). The first step of the Company's framework is to define the relevant market in terms of both product and geographic substitutability (Exh. AT&T-5, pp. 8-9). AT&T argues that the relevant product market in this proceeding is composed primarily of intrastate toll services, including the intraLATA services provided by NET, and the relevant geographic market is the entire Commonwealth (id., pp. 9-10).

The second element of AT&T's framework is to evaluate three fundamental factors that demonstrate the level of market competitiveness: (1) the supply elasticity of other firms; (2) market share; and (3) market demand (id., p. 10). Based on this approach, AT&T concludes that there is sufficient competition for virtually all of AT&T's services in Massachusetts (id., pp. 34, 48). The Company asserts that the Attorney General failed to provide any valid empirical analysis in support of his conclusions, and that the assertions made by the Attorney General are speculative and not supported by accepted economic principles (AT&T Brief, pp. 58-59).

a. The Supply Elasticity of Other Firms

According to AT&T, the supply elasticity of other firms represents the collective ability, willingness, and propensity of competing firms and new entrants to expand sales if the dominant firm raises prices in excess of marginal cost (often referred to as supracompetitive pricing) (id., pp. 19- 20). AT&T claimed that there is high elasticity of supply among its competitors (Exh. AT&T-5, p. 21). One of the Company's witnesses testified that the growing number of IXCs certified in Massachusetts and the growth in the volume of traffic carried by AT&T's competitors is evidence that the regulatory and economic barriers to entry and expansion in this market are low (id., pp. 21-22). The Company argues that a large market share is not correlated with market power if there is also a high elasticity of supply (i.e., if there are actual or potential competitors who can supply service in response to a carrier's price changes) (AT&T Brief, p. 21).

b. Market Share

AT&T maintains that market share data must be analyzed with "extreme caution" (id., p. 20). AT&T identified three reasons that measurements of market share may not accurately predict market power: (1) the unit of measurement (e.g., minutes of use or capacity) may have an impact on the conclusions of the analysis; (2) current market share may reflect prior regulatory policies, not market power; and (3) market share statistics at any point in time are less informative than market share trends over time (id., pp. 20-21).

The Company argues that the proper unit of market share for measuring market power for long-distance telecommunications services is capacity (id., p. 27). [FN15] The Company asserts that it currently has less than 50 percent of the fiber-optic capacity in this country (id., citing Exh. AT&T-5, pp. 25- 26).

***10** The Company contends that minutes of use data are misleading as an indicator of AT&T's market power because the Company's relatively high share of minutes of use is due to past regulatory policies (Exh. AT&T-5, p. 26). Moreover, AT&T states that the trend for minutes of use indicates a decline in AT&T's market share during the period from 1987 to 1990 (AT&T Brief, pp. 28- 29).

AT&T argues that in order to analyze the competitiveness of specialized business services, including all "800" services except Classic 800, the competitive presence of NET must be considered because a large portion of the traffic billed by AT&T for these services is intraLATA (id., p. 30). The Company argues that the subscribers to Classic 800 service, which AT&T offers only as an "add-on" to NET's intraLATA 800 service, are served primarily by NET and have only incidental interLATA usage (id., p. 31). AT&T argues further that the current lack of 800 number portability for Classic 800 customers does not give AT&T a significant competitive advantage, because NET has indicated to the FCC that it will offer 800 number portability starting in March 1993 (id., pp. 32-33). [FN16]

The Company disputes the merit of Sprint's proposal to include Classic 800 in Category D until 800 number portability is available. AT&T notes that Sprint's own witness acknowledged that it would be "foolhardy" for AT&T to attempt to take advantage of its existing customer base through supracompetitive pricing during the brief interim period before NET's 800 number database is in place (AT&T Reply Brief, pp. 10-11, citing Tr. 3, p.64).

AT&T asserts that the market for private line services is competitive between and among IXCs and local exchange carriers without regard to LATA or state boundaries, and that when NET is included in the analysis, AT&T's share of the private line market is relatively small (AT&T Brief, pp. 33-34).

With regard to Volume MTS, AT&T argues that the relevant market is the interLATA market, because the Company does not actively compete for intraLATA MTS business. [FN17] As evidence of "intense competition" for MTS service, AT&T indicates that an average of eight IXCs offer service in the exchanges that have been converted to equal access. AT&T also argues that nonquantitative data, such as the number of promotions and advertisements of AT&T's competitors, demonstrate that Volume MTS is a highly competitive service (id., p. 35).

AT&T asserts that Sprint's proposal to include all residential MTS service in Category D should be rejected because Sprint did not present any evidence or analysis supporting the need for additional regulation to ensure fair prices for high-volume residential MTS users (AT&T Reply Brief, p. 13). AT&T notes that it

offers MTS service to business and residential customers under the same rate schedule. AT&T argues that, consequently, even if it did have market power over Volume MTS provided to residential customers, it could not raise Volume MTS rates excessively because high-usage business customers would react adversely (id.).

c. Market Demand

***11** The last factor AT&T identified to demonstrate the level of market competitiveness is market demand. The Company described three market demand characteristics: (1) market growth; (2) the distribution of demand; and (3) the willingness of consumers to switch firms (Exh. AT&T-5, pp. 16-17). AT&T asserts that there has been substantial year-to-year growth in the telecommunications markets in Massachusetts, that the demand is highly skewed to relatively few high-usage customers, and that customers have switched carriers frequently (AT&T Brief, pp. 39-40, citing Exh. AT&T-5, pp. 31-34; RR-MCI-3).

2. Attorney General

The Attorney General asserts that the Massachusetts interLATA market is not competitive (Attorney General Brief, p. 7). The Attorney General defends the credentials of his witness against AT&T's assertions, arguing that he is an "eminent, mainstream" economist. The Attorney General argues that the testimony he sponsored was directed to the basic concepts and types of information that are relevant to the Massachusetts interLATA market as a whole (Attorney General Reply Brief, pp. 2-3). In response to a criticism made by AT&T, he asserts that it was not essential to the testimony of his witness that the witness have detailed, first-hand knowledge of AT&T's Massachusetts market, since he was able to rely on factual information provided in AT&T's direct case (id., p. 3).

The Attorney General defines the relevant market in this case as the Massachusetts interLATA market (Attorney General Brief, p. 8, n.4). He contends that effective competition normally cannot exist unless the leading firm's market share is well below 50 percent (with revenues being the best measure for market share), and that firm is challenged by a sufficient number of approximately comparable competitors (Exh. AG-11, pp. 36-37; Exh. AG-13).

The Attorney General asserts that it is inappropriate to consider NET's dominance in the intraLATA market as a basis for concluding that most of AT&T's services are sufficiently competitive (Attorney General Brief, p. 17). The Attorney General contends that AT&T should have raised the issue of NET's dominance within the context of D.P.U. 90-133, but that in this case NET's dominance is not relevant to the issue of "effective competition" for AT&T's services (id., pp. 17-18). He argues further that the Department should not find any of AT&T's predominantly intraLATA services to be sufficiently competitive, because that finding could be interpreted as suggesting that NET's provision of similar services should also be free of price regulation (id., p. 18).

He recommends that the Department exercise caution when looking at individual services in isolation, because a carrier may cross-subsidize its competitive services with those services over which it has market power (id., p. 18, citing Exh. DPU-41). The Attorney General argues against any relaxation in the regulation of AT&T that might subject residential customers to exploitative pricing (id., p. 13, citing Exh. AG-11, p. 38).

***12** The Attorney General identifies four factors for analyzing whether the market is sufficiently competitive: (1) the leading firm's market share; (2) the presence of numerous comparable competitors; (3) the ease of entry into the market; and (4) the leading firm's degree of profitability (See Sections a through d, following) (id., p. 8, citing Exh. AG-11, p. 38).

a. The Leading Firm's Market Share

The Attorney General argues that the most general, unbiased measure of a carrier's market share is its percentage of total revenues. He maintains the record shows that AT&T's total intrastate revenues for 1990 were far larger than the combined revenues of all of its competitors (id., p. 9, citing Exh. AT&T-24). The Attorney General further argues that AT&T's market share measured in minutes of use and presubscribed lines supports the same conclusion (id., citing Exh. Sprint-3, p. 14 and D.P.U. 90-133, p. 38).

The Attorney General asserts that the Department's reliance in D.P.U. 90-133 on (1) revenues as the most appropriate unit of measurement for market shares and (2) properly measured market share as the primary indicator of market power is consistent with his positions, not those of AT&T (Attorney General Reply Brief, pp. 6-7). The Attorney General also criticizes AT&T's emphasis on market share trends, arguing that such trends are relevant only if they represent a long-term pattern (id., p. 10). He argues that trends toward increasing market shares for AT&T's competitors may cease or reverse if AT&T's proposal is granted (id.).

b. The Presence of Numerous Comparable Competitors

The Attorney General presented testimony that effective competition would require the presence of at least five comparably sized firms competing vigorously with AT&T (Exh. AG-11, p. 38). According to the Attorney General, this situation does not exist yet in Massachusetts, as AT&T has only two sizable competitors, MCI and Sprint, and they are not vigorous enough to challenge AT&T (Attorney General Brief, p. 10, citing Exh. AT&T-24). The Attorney General characterizes the market as a three-firm oligopoly dominated by AT&T (Exh. AG-11, p. 4). The Attorney General asserts that the record in this case reaffirms the Department's conclusion in D.P.U. 90-133 about the market shares of the interLATA carriers other than AT&T, MCI, and Sprint (Attorney General Brief, p. 10, citing Exh. AT&T-24). [FN18]

c. Entry Conditions

The Attorney General asserts that there is a significant distinction between the legal ability to enter a market and entry as a meaningful economic force in the market (id., p. 11, citing Exh. AT&T-24). He contends that other carriers who have entered the market in Massachusetts are not sufficiently comparable to AT&T, by any measure, to be able to compete effectively (Exh. AG- 11, p. 13). According to the Attorney General, entry itself is not a meaningful measure of competition in a market if the firms that enter the market are unable to match the resources of a dominant firm, which is able to use selective pricing to gain the best customers (Attorney General Brief, p. 11, citing Exh. AG-11, p. 13).

d. The Leading Firm's Degree of Profitability

***13** The Attorney General argues that AT&T has been extremely profitable, with a return on investment in excess of 30 percent (id., citing Exh. AG-11, exh. 2). The Attorney General maintains that it is reasonable to infer that very high accounting profits reflect high economic profits, and that the ability to earn such high profits is evidence of AT&T's dominance (Exh. AG-11, p. 12).

3. Sprint

We note that the testimony of Sprint's witness is not wholly consistent with the arguments in Sprint's briefs. Sprint's witness testified that Sprint is not opposed to alternative regulation for AT&T with respect to business services, but that Sprint is opposed to the inclusion of any residential services and Classic 800 service in Category M (Exh. Sprint-3, pp. 8-9 and 15; Tr. 3, pp. 91-92). However, in its briefs, Sprint argues for denial of AT&T's request for alternative regulation and recommends that all of AT&T's MTS services, including Volume MTS, be removed from Category M (Sprint Brief, p. 2; Sprint Reply Brief, p. 5).

Sprint argues that any change in the form of regulation for AT&T must be analyzed in terms of the precedent set forth in IntraLATA Competition and D.P.U. 90-133 (Sprint Brief, p. 1). Sprint asserts that AT&T's testimony in this proceeding would have the Department ignore the aforementioned Orders in arriving at a decision in this proceeding, especially in terms of the unit of measurement for market shares, the importance of "fringe firms" in the market, and the correlation of market share and market dominance (id., pp. 6-12).

Sprint argues that no residential services should be included in Category M. Sprint maintains that this position is supported by a recent FCC decision concluding, inter alia, that the residential market is not yet fully competitive (Exh. Sprint-3, p. 8). Sprint contends that if AT&T is permitted pricing flexibility for residential Volume MTS service and business services, AT&T can match its competitors' prices for business services while protecting its dominance of the residential Volume MTS market (id., p. 7). Sprint asserts that AT&T has not met its burden of proving that its proposed flexibility in pricing residential services is in the public interest (Sprint Reply Brief, p. 4).

Sprint argues that Classic 800 service should not be included in Category M because, although 800 number portability is expected to be implemented in 1993, it is not yet a reality, and therefore it would be premature to grant AT&T the proposed level of flexibility (Sprint Brief, pp. 14-15).

C. Analysis and Findings

AT&T has requested that many of its services be classified as sufficiently competitive. In order to evaluate AT&T's proposal, it is necessary to define the relevant market for AT&T's offering of these services. Because the usage for many of AT&T's intrastate services in Massachusetts is predominantly intraLATA, we find that the relevant market includes the market for all intrastate services, including the intraLATA toll services offered by NET (Exh. AT&T-3, pp. 9-10).

***14** AT&T and the Attorney General present different interpretations of what constitutes a competitive marketplace. The Attorney General stresses the importance of static analyses, including output-based measures of market share (revenues and minutes of use) as determinants of market power. [FN19] He maintains that effective competition normally cannot exist unless the leading firm's market share is well below 50 percent and that firm is challenged by a sufficient number of approximately comparable competitors. AT&T emphasizes the importance of dynamic market conditions (supply elasticity and market demand trends), as well as properly measured market share, in an analysis of market power in the relevant markets.

The Attorney General's analysis corresponds more closely with the Department's statements in D.P.U. 90-133 as to the correlation of market share and market power and the proper unit of measurement for market share. However, as discussed below, we find that AT&T's economic analysis regarding market power is more relevant in the existing telecommunications marketplace.

A high output-based market share reflects significant market power only when the supply elasticity of other firms is relatively low. Therefore, a comprehensive analysis of AT&T's market power must consider the market's dynamic conditions. The evidence presented in this case strongly suggests that the supply elasticity and demand characteristics of the relevant market are such that should AT&T increase prices to levels significantly in excess of marginal cost, Category M customers will have the incentive and ability to purchase telecommunications services from carriers other than AT&T, and AT&T's competitors (current and potential) will be able to meet this added customer demand by expanding their service availability.

The evidence indicates that Category M customers are willing and able to "price-shop" among carriers in Massachusetts. AT&T's share of the total market, although still large as measured by minutes of use, has declined significantly in recent years (Exh. AT&T-3, p. 8). Furthermore, demand for many Category M services is highly skewed to a few high-usage customers (Exh. AT&T-5, pp. 32- 33). We also note that all Massachusetts exchanges now have equal access, which gives all customers the ability to receive direct access to IXCs who choose to serve those exchanges.

The evidence also indicates that the elasticity of supply of AT&T's competitors is relatively high. By aggressively pursuing AT&T's customers, MCI and Sprint have demonstrated the ability and willingness to expand their output (Exh. AT&T-3, exh. 6). Ease of entry in the market is illustrated by the fact that there are now over 40 IXCs certifiedby the Department to offer service. There are few barriers to entry and expansion in any segment of the market in which these IXCs choose to compete. While many of these firms are resellers, rather than facilities-based carriers such as MCI and Sprint, resellers are able to apply some degree of competitive pressure to AT&T with value-added services and a focus on market niches (Exh. AT&T-5, pp. 30-31). [FN20]

***15** Capacity is a valuable measurement of AT&T's ability to exert market power over the price of its services because capacity measures AT&T's prospective ability to control supply in the market. Although the record does not contain a specific measurement of the capacity of firms in Massachusetts, AT&T's competitors have the capacity to serve enough of AT&T's customers to make it economically irrational for AT&T to engage in supracompetitive pricing (Exh. AT&T-3, p. 17 and exhs. 6-7; Exh. AT&T-5, pp. 23-24; Tr. 3, pp. 51-53). When the supply elasticity of other firms is relatively high, output-based market shares do not fully reflect an individual firm's prospective ability to exert market power. Furthermore, AT&T's output-based market share for various services is at least partially a vestige of AT&T's former status as a monopoly provider of telecommunications services.

Based on the preceding analysis, we find that sufficient market forces are in place to ensure that rates charged by AT&T for its proposed Category M services are just and reasonable. [FN21] If, however, there is evidence of anticompetitive behavior by AT&T, including predatory pricing practices, the Department continues to have jurisdiction to investigate such practices.

We also find it appropriate to allow AT&T to include Classic 800 in Category M, even though 800 number portability is not yet operational. Classic 800 service represents a small and declining portion of the market for 800 services. We also note that AT&T requested, and the Department approved, rate reductions for Classic 800 service in November 1990, June 1991, and March 1992. Moreover, 800 number portability, while not yet a reality, is expected to be in place in March 1993, approximately nine months from now. We note, however, that any significant delay in the introduction of NET's 800 number database may require us to revisit this decision.

We do not agree with Sprint that all residential MTS service should be included in Category D, rather than partially in Category M. The evidence indicates that Volume MTS service is more profitable than Basic MTS and that competition for Volume MTS customers, both residential and business, is vigorous. We note that AT&T does not charge different rates to business and residential MTS customers. [FN22] Therefore, we are persuaded by AT&T's argument that even if it had some market power with respect to residential Volume MTS customers, it could not raise Volume MTS rates excessively without an adverse reaction from Volume MTS business customers.

Accordingly, Volume MTS, MEGACOM WATS, MEGACOM 800, 800 Readyline, Software Defined Network, One Line WATS, Classic 800, 800 Plan E, 800 Plan K, Distributed Network Service, FTS 2000, Accunet Spectrum of Digital Services, Accunet T1.5, optional calling plans, teleconferencing services, and new services [FN23] are hereby reclassified as sufficiently competitive services. AT&T may file tariffs for these services in accordance with minimum statutory requirements. IntraLATA Competition, pp. 39-40, 63-64; D.P.U. 90-133, p. 33.

VI. WEIGHTED-AVERAGE PRICE CAP PROPOSAL

A. Introduction

***16** As determined above, the Department has classified the majority of AT&T's services as sufficiently competitive. Thus, these services are subject to reduced regulatory scrutiny. [FN24] We now turn to the issue of establishing the appropriate level of regulation for Basic MTS, a service proposed for inclusion in "Category D." AT&T proposes that Basic MTS, which is now subject to ROR regulation, instead be subject to a weighted-average price cap.

AT&T proposed that a weighted-average price cap replace ROR regulation for Basic MTS service. The weighted-average price cap would be calculated as follows:

Under AT&T's proposal, "price changes" include all changes in AT&T's MTS rates implemented since 1990 and, on a going-forward basis, all of AT&T's price reductions that result from a decrease in the access charges that AT&T pays to NET. [FN25] Therefore, AT&T considers its rate reductions of May 1991 (-4.64 percent) and March 1992 (-4.72 percent) to be price changes (RR-DPU-8). Including these changes in the calculation results in a weighted-average price cap of $0.176 per minute; i.e., under AT&T's proposal, it would have flexibility to adjust its rates

for low-volume MTS as long as the average revenue per minute would not exceed $0.176 per minute (id.).

AT&T proposes to adjust the price cap to pass through any decrease in access charges that may occur as a result of NET's annual rate restructuring filings. [FN26] An access charge reduction also would be represented in the above formula as a negative percentage price change. AT&T notes that access charges are the Company's single largest cost associated with the provision of MTS service (Exh. AT&T-3, p. 27).

According to the Company's proposal, its weighted-average price cap mechanism would be in effect at least until January 1, 1994. AT&T indicated that at that time, it may request an extension of the weighted-average price cap, or a further modification of its regulatory framework, such as a reclassification of Basic MTS as a Category M service (See Tr. 1, pp. 62-63).

B. Positions of the Parties

1. AT&T

AT&T contends that its weighted-average price cap proposal for Basic MTS service is designed to obviate concerns that AT&T might take advantage of whatever demand inertia exists for low-usage customers (AT&T Brief, p. 50). In order to eliminate any concern that it may attempt to take advantage of customers in geographic areas where there is less competition, AT&T also proposes to continue statewide average pricing (id.). AT&T points out that, even though the Company would have pricing freedom within the weighted-average price cap, each service in Category D would have to be priced to recover its incremental cost (id., pp. 47-48).

An AT&T witness testified that the targeted price cap mechanism is vastly superior to retention of ROR regulation for those individual services that remain price-regulated by the Department, because the weighted-average price cap is a "far less onerous and economically distortionary" method of price regulation (Exh. AT&T-5, pp. 48-49).

***17** AT&T argues that the application of ROR regulation to its intrastate operations in Massachusetts is no longer appropriate. As described by the Company, AT&T "provides international, interstate and intrastate telecommunications services using a common network and common physical and human resources" (AT&T Brief, p. 7). The Company contends that the cost allocations required for ROR regulation of and pricing of AT&T's intrastate services represent an "economically impossible" exercise (id.).

2. Attorney General

The Attorney General advocates that the Department "not relax regulation [of AT&T] until the Massachusetts market is fully competitive, which is still several years away" (Attorney General Brief, p. 13, citing Exh. AG-11). According to the Attorney General, changing the current regulatory requirements at this time is likely to lead to exploitative pricing by AT&T for residential services. He argues that "[i]f the Department wants to achieve a competitive market . . ., it should continue [ROR] regulation for all AT&T services . . ." (Attorney General Brief, p. 14).

The Attorney General claims that although the form of the Company's petition in this case is not identical to the one filed in D.P.U. 90-133, there are few differences in the policy questions raised in the two cases (id., p. 3). The Attorney General contends that the issues raised by AT&T's request in D.P.U. 90-133 to be reclassified as nondominant are virtually the same ones that pertain to an examination of the propriety of a new form of regulation for the Company (id.).

The Attorney General argues that the Department should reject AT&T's proposed weighted-average price cap (id., p. 15). He asserts that since telecommunications is a declining-cost industry and the proposed price cap is fixed based on 1990 data, over time a gap will open up between price and cost (id., citing Tr. 4, pp. 136, 253-254). The Attorney General opposes AT&T's proposal to split residence services between high-volume and low-volume users because, he contends, the record does not support a finding that residential service has two distinct categories (id., citing Tr. 4, p. 238).

The Attorney General asserts that the weighted-average price cap would not provide significant protection for all Basic MTS users. He maintains that the weighted-average price cap would not prevent AT&T from raising rates to several times their current levels in the lower-volume mileage bands and rate periods, while reducing rates substantially in the higher-volume mileage bands and rate periods, thus undercutting competition (Attorney General Brief, pp. 16-17, citing Exh. DPU-42; RR-AG-2).

3. MCI

MCI considers AT&T's attack on ROR regulation to be entirely too broad (MCI Reply Brief, p. 2, n.2). Nonetheless, MCI states that it is not opposed to the lifting of ROR regulation from the services in question in this docket because "AT&T, while still the dominant interexchange carrier in Massachusetts, is not the supplier of bottleneck monopoly services or functions" (id., p. 2).

4. Sprint

***18** Sprint argues that while the form of regulatory relief is different, the arguments made in support of AT&T's requested relief in this proceeding are the same as those made in D.P.U. 90-133 (Sprint Brief, p. 6). Sprint asserts, however, that it is not opposed to limited relaxation of ROR regulation for AT&T's competitive services (id., p. 13).

5. NELF

NELF argues that AT&T has demonstrated the sufficiency of its proposal to replace ROR with a weighted price cap for protecting "consumers and competitors in as-yet noncompetitive submarkets" (NELF Reply Brief, p. 2). According to NELF, the costs for telecommunications are a large and increasing portion of the operational costs of many businesses. It maintains that a policy decision that enables companies like AT&T to reduce the costs of telecommunications services will directly benefit many Massachusetts businesses (id.).

C. Analysis and Findings

1. Introduction

In general, regulation serves as a surrogate for market forces in markets not characterized by effective competition. In markets served by a monopoly provider of utility service, that provider traditionally has been regulated by rate base, ROR regulation. As first articulated by the Department in IntraLATA Competition, the existence of a "high degree" of competition obviates the need for such regulation. IntraLATA Competition, p. 18. One of the Department's goals in establishing a regulatory framework for the telecommunications industry is to ensure that the framework is "flexible enough to react to changes in the telecommunications marketplace" in the future. Id., pp. 18- 19.

The telecommunications marketplace has undergone substantial changes, which have dramatically altered the industry and have increased significantly the competitiveness of certain market segments. Based on the record in this case, the Department finds it appropriate to replace ROR regulation with the alternative form of regulation for AT&T described herein.

Because this docket addresses a petition filed by AT&T, a dominant interexchange carrier, [FN27] the findings herein apply only to the application of ROR regulation to AT&T. We are making this decision on a petition presented by AT&T, based on evidence presented by AT&T and other parties to this case. Accordingly, this proceeding is relevant to AT&T only, and thus creates no controlling precedent for the Department's regulation of NET. [FN28]

Furthermore, the Department finds that the relief requested by AT&T in this case is easily distinguishable from the Company's request in D.P.U. 90-133. In the previous case, AT&T petitioned the Department to be reclassified as a nondominant carrier, but did not request the approval of a different mode of regulation. In the Order in D.P.U. 90-133, the Department rejected AT&T's request for nondominant status and noted that "consideration of alternative forms for regulating AT&T . . . is beyond the scope of this proceeding." D.P.U. 90-133, p. 33, n.8. The scope of the current docket clearly encompasses an examination of an alternative form of regulation for AT&T.

2. Price Cap Mechanism

***19** In Section V, supra, we concluded that market-based pricing will result in just and reasonable rates for the majority of AT&T's telecommunications services. In this section, we set forth the appropriate regulatory safeguards for AT&T's remaining services, i.e., those in Category D, which are Basic MTS and operator services.

While the level of competition for Basic MTS is less than for the services now classified as Category M, if AT&T's Basic MTS customers are not satisfied with either the price or quality of AT&T's service, they typically can select from among many other interexchange carriers. [FN29] Furthermore, the Basic MTS rates that will be in effect as a result of today's Order will continue to reflect statewide-average pricing, and thus AT&T will not treat low-volume customers differently based on where they reside. Under AT&T's proposal, the weighted average price cap

of $0.176 per minute represents the maximum average rate that AT&T could charge until January 1, 1994.

Cost-based regulation is certainly warranted when customers lack a realistic opportunity to switch service providers. If AT&T has market power over Basic MTS customers, it arises from some level of demand inertia, not bottleneck control of the market. The Department has previously stated, "it is appropriate that, as competitive forces begin to take hold in a market, the Department should begin to reduce the degree of regulation in that market, so that the benefits of competition may be enjoyed by the public." IntraLATA Competition, p. 55.

The proposed weighted-average price cap is an appropriate means for regulating a market that is not subject to the natural monopoly conditions that ROR regulation was designed to address. Also, it is unlikely that even the most comprehensive cost-of-service study could accurately allocate costs for the Massachusetts portion of AT&T's integrated international network.

We find that, with the directives described, infra, AT&T's price cap mechanism contains sufficient regulatory safeguards to augment the market forces in place and result in just and reasonable rates for its Basic MTS customers. Under this new regulatory scheme, AT&T may not propose to raise the weighted-average price for Basic MTS above $0.176 per minute, until, at the earliest, January 1, 1994. We further direct that any proposed rate changes to be implemented under the approved weighted-average price cap be accompanied by documentation demonstrating that the Company's average revenue per minute for Basic MTS service will not exceed the weighted-average price cap.

Although telecommunications is a declining-cost industry, the largest single cost to AT&T consists of the access charges it must pay to NET (Exh. AT&T-3, p. 27). In order to ensure that users of Category D services benefit from any future reductions in these charges, we direct AT&T to pass through in a timely manner in its rates for Basic MTS and operator-handled services any access charge reductions. The effect of our approval of AT&T's proposed price cap mechanism and proposal to classify certain services as Category D services is that the weighted-average rates for these services will not increase, and indeed, are likely to decrease during the next couple of years.

***20** In response to the Attorney General's concerns regarding cross- subsidization within Basic MTS service, we note first that there is no evidence indicating that there is a difference in the level of competitiveness among mileage bands or among rate periods. Second, for Basic MTS, or for any other service, AT&T is not permitted to charge rates that do not cover marginal cost. See IntraLATA Competition, p. 33; D.P.U. 85-137, p. 137 (1985).

VII. COST ALLOCATION AND SUFFICIENTLY COMPETITIVE SERVICES

We have determined in Section V, supra, that AT&T's proposed Category M services are sufficiently competitive. The only services offered by a dominant carrier that the Department has previously determined to be sufficiently competitive are certain of those offered by NET, a carrier that is subject to ROR regulation. D.P.U. 84-82 (1984) (Centrex); D.P.U. 85-275/276/277 (1985) (Centrex); D.P.U. 88-18-A (1988) (Intellidial). In its Orders regarding these services, the Department indicated that, in a general rate case, the costs of the sufficiently competitive services must be allocated seperately to prevent the cross-subsidization of a carrier's competitive services by its monopoly services. D.P.U. 85-275/276/277, p. 4.

In D.P.U. 90-133, the Department indicated that AT&T could seek to have certain of its services classified as sufficiently competitive (See Section V.A, supra). D.P.U. 90-133, pp. 32-33. However, under the alternative form of regulation that will apply as a result of this Order, AT&T will not be submitting cost of service studies to the Department, and, therefore, the cost allocation process for sufficiently competitive services that is described for NET, supra, will not occur. Instead, the combination of a price cap for Basic MTS, the flow-through of access charge reductions to Category D services, and competitive market pressures for Category M services will discourage the type of cross-subsidies that the cost allocation process is intended to prevent.

Because we are eliminating ROR regulation for AT&T (See Section VI.C, supra), we consider it useful to adopt new nomenclature to reflect the regulatory distinction between "sufficiently competitive" services and AT&T's Category M services. "Sufficiently competitive" will continue to be the Department's classification for services offered by ROR-regulated telecommunications carriers for which prices set by the market are fair and reasonable. Category M will be a new classification, similar to the sufficiently competitive category, that will apply to AT&T's services for which the Department determines that prices set by the market will be fair and reasonable. The Department will not explicitly review the allocation of AT&T's costs between its Category M and its Category D services. [FN30]

VIII. AT&T'S PROPOSALS REGARDING TARIFF FILINGS AND REPORTING REQUIREMENTS

A. Tariff Filings

As stated in Section III, supra, tariff filings submitted by telecommunications common carriers take effect on no less than 30 days' notice, unless the Department determines that good cause is shown for an earlier effective date. G.L. c. 159, § 19. [FN31]

***21** AT&T requests that the Department allow rate reductions filed by an IXC, or rate reductions coupled with a rate restructuring, to become effective on less than 30 days' notice (Exh. AT&T-2, pp. 23-24). AT&T also requests that a shorter notice period be applied to new service offerings (id., p. 24). While the Company did not propose a specific notice period, one of its witnesses spoke favorably of a provision in New York State, which allows rate reductions to become effective on one day's notice (Tr. 1, pp. 84-85).

According to AT&T, a shortened notice period would result in the earlier availability to customers of lower prices and new services (Exh. AT&T-2, p. 24). The Company stated that Massachusetts tends to be at the "tail end" of AT&T's service implementation program because other states have shorter notice periods (id.). AT&T prefers a shorter notice period, because it would provide some assurance that competitors would not have time to upstage the Company by responding to an offering by AT&T before the tariff effective date (id.). The Company contended that a shorter notice period would encourage all IXCs to introduce innovations in Massachusetts more quickly (id.).

No other party directly addressed this issue.

When a tariff is filed, it undergoes administrative processing and review by the Department. The tariff review process involves a determination that the filing is

complete, accurate, understandable, internally consistent, consistent with the applicable statutes and regulations, and in accord with the Department's stated policy goals. This review process is necessary for the Department to fulfill its statutory obligation to determine that the tariff provisions are just, reasonable, and not unduly discriminatory. Based on the volume of tariff filings made with the Department, this review process, as a general rule, cannot reasonably take place within a period shorter than 30 days.

The Department has a critical interest in the exploration and implementation of technological innovation in the telecommunications market. Innovation can result in the introduction of services that meet consumers' immediate needs and also in efficient and economic applications that are yet not imagined. Also, the Department looks favorably on reductions in rates. The Department's tariff review process reflects its regard for both technological innovation and rate reductions: the Department makes every reasonable effort to allow tariffs that reflect innovation or rate reductions to become effective as soon as is legitimately possible. Therefore, we find that our present tariff review process does not unnecessarily restrict the introduction of technological innovation or the implementation of rate reductions within our statutory mandate.

Any benefits that would accrue from shortening the notice period are outweighed by the undue administrative burden that would result from having to perform tariff review for all IXCs' filings in a significantly reduced period of time. For this reason, we do not consider it appropriate to change the 30- day notice period. [FN32] However, carriers may petition for a reduced notice period, and the Department will continue to exercise its discretion in evaluating any request to allow a tariff to go into effect in less than 30 days upon a showing of good cause. [FN33]

B. Reporting Requirements

***22** In its Order in IntraLATA Competition, the Department established a reporting requirement as part of its regulatory framework for the telecommunications industry. Therefore, in addition to filing an annual return with the Department, a telecommunications carrier must file quarterly information on both interLATA and intraLATA operations, "including number of customers, revenues, revenue distribution among services offered, number of customers per service, demand or market penetration forecasts for the next three-month period, and investment and cost data" for that quarter. IntraLATA Competition, p. 84. This reporting requirement assists the Department in the monitoring of the development of competition in the state's telecommunications markets.

AT&T proposes that the Department institute a requirement for an annual "Competitive Data Report" (Exh. AT&T-2, pp. 30-32). Under AT&T's proposal, the Competitive Data Report would be filed by each IXC and NET and would contain the following information, displayed on a quarterly basis:

For MTS (NET would not file this data)

Total lines served as primary carrier Billed minutes of use Revenues Prices for typical calls (e.g., 5 min., 70-mile evening call)

For specialized business services (outbound services)

Total accounts served Billed minutes of use (inter- and intraLATA shown

separately) Revenues (inter- and intraLATA shown separately)

For specialized business services (800 service)

Total accounts served Billed minutes of use (inter- and intraLATA shown separately) Revenues (inter- and intraLATA shown separately)

For private line services

Total accounts served Billed links located in Massachusetts (intra- and interstate) Revenues

(id., pp. 30-31).

AT&T also proposes that the Department obtain from NET, as the principal provider of access service in Massachusetts, data concerning services provided to each IXC. According to AT&T, these data would assist the Department in confirming the reasonableness of each IXC's Competitive Data Report (id., p. 31). AT&T proposes that the data include the following:

Total switched access minutes of use Originating switched access minutes of use Terminating switched access minutes of use Originating switched access minutes of use (800 service only) Special access lines (intra- and interstate)

(id.).

AT&T contends that with these data the Department would be able to examine the total IXC-market, as well as changes in market shares over time (id., pp. 31-32). AT&T also maintains that these data and other statistics regarding customer complaints would allow the Department to analyze the consumer benefits of expanding competition (id., p. 32). AT&T recommends that the Department treat the Competitive Data Report and the data from NET on each IXC as proprietary (Tr. 1, pp. 100-101). AT&T also proposes that the results of any Department analysis of these data, without identification of specific carriers, be treated as public information (id., pp. 101-102).

***23** No other party directly addressed this issue on brief.

We find that a Competitive Data Report, as proposed by AT&T, would provide useful information on each IXC's share in particular markets and is a good substitute for the IntraLATA Competition reporting requirements. We also find that it is reasonable to require such reports annually, with data displayed on a quarterly basis. We further find that consistently applied reporting requirements are necessary for the Department's evaluation of competition in the market.

In order for the Department to evaluate the markets for telecommunications services in Massachusetts, we require information on the major competitors, but not information on all certified carriers. We find that annual revenue levels are an appropriate measure to identify major IXCs for purposes of reporting requirements because carriers submit annual reports to the Department that include revenue data. See G.L. c. 159, § 32. The record in this case shows that, based on intrastate revenues, AT&T, MCI, and Sprint are, by a considerable margin, the largest IXCs in Massachusetts (Exh. AT&T-24). The record also demonstrates that, based on annual

revenues, NET has a significant share of the intraLATA business service market in Massachusetts (id.).

Therefore, we direct that NET, as the dominant LEC, and all IXCs with annual intrastate Massachusetts revenues of $10,000,000 or more, based on the previous calendar year's annual return with the Department, file a Competitive Data Report with the Department's Telecommunications Division. The Competitive Data Report shall be filed annually by March 31 for the preceding 12-month calendar year ending December 31. The Competitive Data Report must contain the annual data, displayed quarterly, as outlined in AT&T's proposal, and in a format to be determined by the Department's Telecommunications Division. The Competitive Data Report also must contain a separate section, to be completed by NET, that presents data on services provided by NET to each IXC, as described in AT&T's proposal.

The requirement for filing a Competitive Data Report supersedes the reporting requirements for AT&T and all other IXCs with annual intrastate Massachusetts revenues of $10,000,000 or more established in IntraLATA Competition. All other reporting requirements, such as those which have been established in other Orders for providers of pay-telephone service, shall remain in effect.

The Department will treat the Competitive Data Report as proprietary and will protect the report against public disclosure to the extent permitted by law. [FN34] The Department directs the Company to file within 30 days of the date of this Order a sample Competitive Data Report in a proposed format, which shall include both a written and a computer-diskette version. Interested parties may comment on AT&T's suggested written format within fifteen days of AT&T's submission.

IX. IMPLICATIONS FOR REGULATION OF ALTERNATIVE OPERATOR SERVICE PROVIDERS

***24** The Company proposes no changes in the Department's regulation of AT&T's operator services. However, we are cognizant of the implications for consumer protection of any regulatory actions regarding these services. As first articulated in International Telecharge, Inc., companies that provide operator services are considered dominant carriers in their provision of these services at subscriber locations. ITI, D.P.U. 87-72/88-72, p. 12 (1988). The Department stated that the determination of dominant status "means that the Department must evaluate [the carrier's] tariff to ensure that [the carrier's] rates are just and reasonable." ITI, p. 12. Under the Department's current framework for regulating alternative operator services, companies which provide service may file tariffs in which all rates and charges to be paid by the user of the telephone "are identical to, or lower than, the corresponding NET and AT&T rates presently on file [with the Department] . . ." Id., p. 17. This option was an alternative to the filing of all appropriate information to allow the Department to review the reasonableness of expenses, rate base, and rate of return.

The justification for allowing alternative operator service providers the option of filing rates that were at or below those of NET and AT&T was, inter alia, that those rates had "been found to be just and reasonable . . . based on traditional ratemaking principles" (citations omitted). Id. Although ROR regulation will no longer apply to AT&T's provision of intrastate services, we find that no change is warranted in the Department's policy regarding the rates for alternative operator services. AT&T proposed neither a change in its operator service rates nor a change in the manner in which proposed tariff filings for these services would be reviewed by the Department. Accordingly, any provider of alternative operator services who wishes to charge rates higher than those charged by NET or AT&T, must file full

cost support information to justify any such rates.

X. CONCLUSION

Generally, under this new regulatory scheme, AT&T will: (1) price its Category M services based on market considerations; (2) price MTS for low-volume users according to a weighted-average price cap; and (3) retain the rates for operator services at their present or lower levels, until and unless any price increases for operator services are justified by marginal cost information and any other data the Department deems appropriate.

As stated above, we find that AT&T's Category M services do not require direct price regulation to ensure that the rates for these services are just and reasonable. Furthermore, we find that the regulatory framework adopted herein will result in adequate competitive pressure and regulatory safeguards for Category D to discipline AT&T in its price-setting.

Reducing the level of regulation of AT&T will increase competition, which, in turn, will lead to greater benefits to consumers of telecommunications services, such as technological innovations, an increase in the diversity of telecommunications offerings, reasonable rates, and reliable quality of service. IntraLATA Competition, p. 25.

***25** The findings made in this Order do not limit the Department's authority to reconsider the rulings made herein or to implement any other form of regulation for AT&T's intrastate services. In order to monitor the competitiveness of the market, the Department will review the reports which AT&T, MCI, Sprint, and NET submit in compliance with the directives contained herein (See Section VIII.B), and take whatever action is deemed necessary to remedy any market failure in the intrastate telecommunications market.

XI. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That the petition for an alternative form of regulation filed by AT&T Communications of New England, Inc., on April 12, 1991, be and hereby is approved, as modified herein; and it is

FURTHER ORDERED: That AT&T Communications of New England, Inc., shall file an annual Competitive Data Report, to contain the data described herein; and it is

FURTHER ORDERED: That the Secretary of the Department shall, within five days of this Order, issue a copy of this Order to all interexchange common carriers with annual intrastate Massachusetts revenues of $10,000,000 as determined by the most recent annual return on file with the Department; and it is

FURTHER ORDERED: That AT&T Communications of New England, Inc., shall comply with all other directives specified herein.

FOOTNOTES

FN1 In this Order, the term "intrastate" refers to intrastate, intraLATA, and intrastate, interLATA; the term "interLATA" refers only to intrastate, interLATA.

FN2 AT&T states that its proposal is not intended to cause any change in (1) the Department's authority to regulate the entry and exit of IXCs, (2) the statutory obligation of common carriers to provide all services pursuant to approved tariffs, and (3) the Department's authority to review and resolve consumer complaints.

FN3 By its Order in D.P.U. 90-133, the Department directed AT&T to make two separate filings. The first filing, due on May 1, 1991, would have included general tariff revisions reflecting a revenue requirement determination. The second filing, due on October 15, 1991, would have included a fully distributed cost study and a marginal cost study for all of AT&T's intrastate services. AT&T Communications of New England, Inc., D.P.U. 90-133, pp. 45-46 (1991).

FN4 Effective March 1, 1992, Sprint's corporate name was changed from US Sprint Communications Company Limited Partnership.

FN5 The Department first referred to the concept of sufficiently competitive in IntraLATA Competition at pages 39-40.

FN6 In docket D.P.U. 89-1A, the hearing officer required a party to refile its brief without reference to an excluded exhibit and without argument based on information contained in the excluded exhibit. Boston Edison Company, D.P.U. 89-1A-1, pp. 4-5 (1989). The Department upheld the hearing officer's directive. Id., p. 7.

FN7 For example, in its Order in D.P.U. 87-19-A, the Department referred to James C. Bonbright, Albert L. Danielsen, David R. Kamerschen, Principles of Public Utility Rates (2d ed. 1988), regarding a definition of price discrimination. Hull Municipal Light Plant, D.P.U. 87-19-A, p. 42, n.9 (1990). This text was not part of the record evidence in the case, and none of the authors appeared as witnesses.

FN8 See note 19 on page 31 for a definition of market power.

FN9 The Company's complaint that the Attorney General's responses to AT&T's information requests did not contain references to specific pages in the Scherer and Ross Text is without merit. If the Company required more specific responses by the Attorney General, it should have sought the information directly from the Attorney General, or, if necessary, the Company could have sought the assistance of the Department in obtaining the information. See 220 C.M.R. 1.06(6)(c)4 (a party may seek an Order to compel compliance with its discovery request). The Company did not file any such motion to compel.

FN10 Category M services include Volume MTS, MEGACOM WATS, MEGACOM 800, 800 Readyline, Software Defined Network ("SDN"), One Line WATS, Classic 800, 800 Plan

E, 800 Plan K, Distributed Network Service (all of which are high-volume services used primarily by business customers); FTS 2000 (service provided to the U.S. Federal Government); Accunet Spectrum of Digital Services (private line services other than high-capacity service); Accunet T1.5 (high-capacity private line service); optional calling plans; teleconferencing services; and all new services (Exh. DPU-1).

FN11 AT&T defines "Basic MTS" as service provided to customers whose total monthly bills for intrastate, interstate, and international MTS calling are $5.00 or less. The term "Volume MTS" applies to service provided to customers whose total AT&T MTS bills are more than $5.00 per month.

FN12 According to AT&T's intrastate tariff on file with the Department, operator-handled calls include calls for which the customer reaches the operator to request assistance in dialing the called number or calls for which the customer dials "0" or AT&T's five-digit access code followed by the called number (AT&T D.P.U. - Mass. No. 1, § 5, p. 3.1).

FN13 The information required by the Department is similar to information required by the FCC for interstate operations, e.g., general information on the structure and ownership of the company; financial information regarding balance sheet accounts and income and expense accounts; and an analysis of plant accounts, including additions and retirements. See 47 U.S.C. 291.

FN14 The Department also has adopted the additional telecommunications policy goals of simplicity, earnings stability, and continuity. New England Telephone and Telegraph Company, D.P.U. 86-33-C, p. 22 (1987).

FN15 AT&T defines capacity as a measure of "the ability of existing firms to rapidly expand output or service availability in response to an attempted price increase by the firm whose market power we are assessing" (Exh. AT&T-5, p. 13).

FN16 Number portability enables a customer to use any interexchange carrier in conjunction with a particular 800 number. Because of the technical limitations of local exchange carriers' networks, 800 numbers are not currently portable. NET plans to implement its 800 database, which will facilitate portability, in March 1993 (RR-DPU-4).

FN17 AT&T began offering "10-xxx" access for intra- and interLATA MTS calling on June 21, 1991.

FN18 In D.P.U. 90-133, the Department stated, "While many interexchange carriers and resellers have been certified by the Department, most are fringe companies with an extremely small share of the market." D.P.U. 90-133, p. 38.

FN19 According to generally accepted economic theory, a firm with market power has the ability to raise the price of its product or service, and to sustain this price

increase over a period of time, without losing so many sales that the price increase is not profitable.

FN20 Furthermore, AT&T does not have bottleneck control over the "wholesale" market; thus, resellers can purchase service from AT&T or AT&T's facilities- based competitors.

FN21 In reaching this conclusion, we do not make any findings as to AT&T's classification as a dominant carrier, because this matter was not at issue in this proceeding and because the record does not demonstrate that AT&T should be reclassified as nondominant.

FN22 Because AT&T is required to file a tariff for the Department's review before it may modify its rates, the Department would have an opportunity to examine any proposal by AT&T to differentiate between residential and business Volume MTS customers.

FN23 We note that since April 1991, the Department has approved a number of tariff filings made by AT&T to offer new services, e.g., Distributed Network Service. This and all other services introduced by the Company after April 1991, since they fall into the category of new services, shall be classified as Category M services.

FN24 See Section VII, infra, for further discussion of the regulatory oversight of AT&T's proposed Category M services.

FN25 AT&T uses data from 1990 in its calculation of the weighted-average price cap because they were the most recent data available at the time that AT&T submitted its petition.

FN26 The record in D.P.U. 89-300 (1990) indicated, inter alia, that NET's revenues from switched access service exceeded the corresponding costs. Id., pp. 38-39.

FN27 In its Order in International Telecharge, Inc., the Department determined that providers of operator services also would be classified as dominant because their services are used by transient end users who may not have choices among service providers. International Telecharge, Inc., D.P.U. 87-72/88-72 (1988). See Section IX, infra, for a discussion of the implications of this Order for alternative operator service providers.

FN28 We note that AT&T's petition includes a proposal for new reporting requirements. This aspect of the proposal would affect other carriers, and is discussed in Section VIII, infra.

FN29 We note that there is a nominal fee for customers who switch their presubscribed IXC. That fee is charged to the customer by the local exchange carrier.

FN30 As discussed in Section VI, supra, however, Basic MTS customers will benefit fully from any reduction in AT&T's access charges.

FN31 The Department also may suspend the operation of any proposed tariff for up to six months to allow for further investigation into its propriety. G.L. c. 159, § 20; G.L. c. 25, § 18.

FN32 If AT&T seeks flexibility in Massachusetts to effect price changes, especially rate reductions, within a "tariffed band" on shorter notice, such as is available in New York and under the regulations of the FCC, it is our opinion that amendments would be required to the statutory framework governing tariff filings (e.g., G.L. c. 159, § 19, regarding rates on file and 30-day notice period). Such a change in the statute may address the Department's mandate to review tariffs carefully, while allowing rate reductions within a Department-approved range of rates to become effective more quickly than is typically possible under the existing statute.

FN33 Good cause is determined by the Department on a case-by-case basis, and we do not here set any standard for good cause. However, we do note that a carrier's failure to plan adequately the timing of its service offering or rate change does not constitute good cause. Carriers must plan the timing of any tariff filing to allow for the required notice period and Department review.

FN33 The Department, from time to time, may review the contents of the Competitive Data Report to determine whether all data shall remain proprietary or whether some data shall be treated as public information. The applicable laws governing the treatment of this information as public or proprietary include G.L. c. 4, § 7 (definition of "public records"); G.L. c. 66, § 1 et seq. (Public Records Law); G.L. c. 66A, § 1 et seq. (Fair Information Practices Act); and G.L. c. 25, § 5 D (authority of the Department to protect confidential information from disclosure). To the extent appropriate, the Department also may be guided by the federal Freedom of Information Act. 5 U.S.C. § 1, et seq.

END OF DOCUMENT